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Washington, DC 20224

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Person To Contact:
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Telephone Number:

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Date:
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Legend

Taxpayer =
Father =
Mother =
Sister =
Trust 1 =
Trust 2 =
Bank =

Company =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
Date 5 =
Year 1 =
Year 11 =
Year 22 =
Country A =
Country B =
Country C =
State A =
State B =

Dear :

This is in response to your authorized representative's submission dated May 31, 2007, requesting rulings regarding the income, gift, estate, and generation-skipping transfer (GST) tax consequences of the proposed transaction.

The facts submitted and representations made are as follows. On Date 1 in Year 22, Father and Mother (Settlors) established Trust 1, an irrevocable trust. Approximately one month later in Year 22, Trust 1 was funded. Year 22 is after January 1, 1967. It is represented that Trust 1 was funded with assets that did not have a situs in the United States, except for a portion of assets consisting of securities in U.S. corporations. The trustee of Trust 1 is Bank. Clause 2 of Trust 1 provides that the trust is governed by the laws of Country C.

The Second Schedule of Trust 1 provides that Father and Mother are entitled to a distribution of all income from investments made by the trustee, together with such distributions of capital as the trustee may determine. Upon the death of both Father and Mother, the beneficiaries shall be their children, Taxpayer and Sister. Taxpayer and Sister shall be entitled to an equal distribution of the income from investments made by the trustee, as well as a distribution of capital in the amount of one-half the capital value of the trust at the time of the death of Father or Mother. The trustee shall pay the capital distribution to these beneficiaries in such manner as it deems most effective from a tax-planning standpoint, provided that the distribution is made within five years (Five-Year Distribution). Upon the death of Taxpayer and Sister, the beneficiaries of the trust will be the surviving children of Taxpayer and Sister, in equal shares. Each of these beneficiaries shall be entitled to the income from the investments made by the trustee, together with a distribution of their proportionate share of the capital of the trust upon attaining the age of 30 years (Remainder Appointment).

Clause 5, paragraph (c) provides that the trustee shall pay or transfer the whole or any part or parts of the capital or income of Trust 1 to the trustees for the time being of any other trust wheresoever established or existing and whether governed by the laws of Country C or by the law of any other state or territory under which any one or more of the beneficiaries are interested notwithstanding that such other trusts may also contain trust powers and provisions (discretionary or otherwise) in favor of some other person or persons or objects if the trustee, in his or her absolute discretion, considers such payment to be for the benefit of such one or more of the beneficiaries.

Clause 1, paragraph (n) provides that the term "Trust Period" means the period commencing on the date of Trust 1 and ending on whichever shall be the earlier of the following days: (i) the day on which shall expire the period of one hundred fifty years from the effective date of Trust 1; (ii) such day (if any) earlier than (i) above as the trustees may at their absolute discretion by instrument in writing appoint; provided however, that if any trust fund owing to its character as a charitable trust or otherwise shall not be subject to the rule against perpetuities, the rules against accumulations, or other similar rules, Trust 1 shall continue in existence in perpetuity or until all property held in Trust 1 is distributed.

Father, a citizen of Country A and a resident in Country B, died on Date 2. Mother, a citizen and resident of Country B, died on Date 3. Father and Mother were

survived by Taxpayer and Sister. Taxpayer resides in and is a citizen of the United States.

It is represented that on the dates of their respective deaths and at the time they established Trust 1, Father and Mother were each non-resident aliens, for purposes of the federal income, estate, gift and generation-skipping transfer taxes. Neither Father nor Mother was ever a citizen of the United States. However, from Year 1 to Year 11 Father and Mother resided in the United States because Father was employed in State A. In Year 11, Father and Mother returned to Country B to reside permanently. It is represented that their return to Country B was not motivated by a desire to avoid United States taxes. Following their return to Country B, Father and Mother only spent a nominal number of days in the United States in any given year. Trust 1 was established and funded in Year 22, more than 10 years after Father and Mother returned to Country B.

Upon Father's death, a portion of Trust 1 consisted of securities with a situs in U.S. corporations. On Date 4, the executor of Father's estate filed Form 706-NA, United States Estate (and Generation-Skipping Transfer) Tax Return with the Internal Revenue Service. On Schedule G of Form 706-NA, the executor included one-half the value of these securities in Father's gross estate. It is represented that Trust 1 did not own any assets with a situs in the United States at the time of Mother's death.

Bank, as trustee of Trust 1, proposes to exercise its discretion under the terms of Trust 1 to appoint Taxpayer's share of the Five-Year Distribution and Remainder Appointment (one-half of Trust 1) to Trust 2, an irrevocable trust, governed by the laws of State B.

Trust 2 was established on Date 5. The trustee of Trust 2 is Trust Company. Article 1(A) of Trust 2 provides that the trustee of Trust 2 is authorized to pay any one or more of Taxpayer and Taxpayer's descendants living from time to time so much of the net income and principal of Trust 2 as the Independent Trustee deems advisable, in equal or unequal shares and to the exclusion of any one or more of them. Any net income not paid to Taxpayer or Taxpayer's descendants shall be accumulated and added to principal at least annually. Under Article 1(B), the Independent Trustee may exercise its power under Article 1(A) to distribute net income and principal of Trust 2 by appointing any part or all of such principal and net income to the trustee of a trust to benefit Taxpayer and Taxpayer's descendants.

Article 1(C) provides that, notwithstanding any other provision in Article 1, during the lifetime of Taxpayer, the net income and principal of Trust 2 shall be paid to or held for the benefit of any one or more of Taxpayer's descendants as Taxpayer (with the consent of the Independent Trustee) may specify and appoint by a document executed with all the formalities of a will.

Article 1(D) provides that upon Taxpayer's death, Trust 2 shall terminate and the trustees shall distribute the remaining principal and any undistributed income to or for the benefit of any one or more of Settlers' descendants (excluding Taxpayer, Taxpayer's estate, Taxpayer's creditors and the creditors of Taxpayer's estate) as Taxpayer appoints by will making specific reference to this special power of appointment; provided, however, that such special power shall not be exercised in a manner that would cause the property subject to the special power to be includible in Taxpayer's gross estate pursuant to § 2041(a)(3) of the Internal Revenue Code. The trustee shall divide and set apart the balance of the principal and undistributed income then on hand, over which Taxpayer does not effectively exercise the foregoing power of appointment, per stirpes, for Taxpayer's then living descendants or, if there is none, for the then living descendants of Father, as provided further in Trust 2.

Article III provides that the trusts created under Trust 2 shall terminate no later than the end of the Trust Period as such term is defined in Trust 1. Upon termination of the trust (or portion thereof) pursuant to the provisions of this Article, the property constituting the then principal of the trust, together with any net income then on hand or accrued, shall be distributed (A) to the person for whose primary benefit such trust was created or, if there is none (B) to the beneficiary to whom distributions of trust income might then be properly made (or, if there is more than one such beneficiary, to such beneficiaries who are descendants of the Settlers, per stirpes, or, if none of them is a descendant of Settlers, in equal shares to the persons to whom the trustees may pay income).

Article VII (G) provides that notwithstanding any other provision of Trust 2, (1) no trustee may participate in any decision as a trustee to make a discretionary distribution (a) in his or her own favor, or (b) discharging his or her legal obligations, and (2) no descendant of Settlers who is serving as a trustee may participate in any decision as a trustee relating to discretionary distributions.

Article XIII(E)(7) defines the term "Independent Trustee" to mean a trustee that: (a) is not a person (a beneficiary) having a beneficial interest (other than as a potential appointee under a power of appointment held by another); present or future, vested or contingent, direct or indirect, in the income or principal of any trust created under Trust 2; (b) is not a person (a contributor) who makes or is deemed to make a gratuitous transfer to the trust; and (c) is not related or subordinate to a beneficiary or a contributor (within the meaning of § 672(c)).

You request the following rulings:

1. Neither the Five-Year Distribution nor the Remainder Appointment from Trust 1 to Trust 2 will cause either of the trusts to recognize gain or loss for purposes of § 1001, and the basis of the assets of Trust 2 as well as the holding period for those assets will remain the same after the proposed distributions.

2. No aspect of either the Five-Year Distribution or the Remainder Appointment will give rise to a gift for purposes of § 2501 as to Taxpayer, nor will future distributions from Trust 2 be subject to gift tax as to Taxpayer.

3. No aspect of either the Five-Year Distribution or the Remainder Appointment will cause the generation-skipping transfer tax under § 2601 to apply to an otherwise taxable termination or taxable distribution from Trust 2.

4. No aspect of either the Five-Year Distribution or the Remainder Appointment will cause the inclusion of any part of Trust 2 in the estate of Taxpayer.

Ruling #1

Section 61(a)(3) of the Internal Revenue Code provides that gross income includes gains derived from dealings in property and, under § 61(a)(15), from an interest in a trust.

Section 1001(a) provides that the gain from the sale or other disposition of property shall be the excess of the amount realized over the adjusted basis provided in § 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in § 1011 for determining loss over the amount realized.

Section 1001(b) provides that the amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received. Under § 1001(c), except as otherwise provided in subtitle A, the entire amount of gain or loss, determined under § 1001, on the sale or exchange of property shall be recognized.

Section 1.1001-1(a) of the Income Tax Regulations provides that the gain or loss realized from the conversion of property into cash, or from the exchange of property for other property differing materially either in kind or in extent, is treated as income or loss sustained.

Cottage Savings Ass'n v. Commissioner, 499 U.S. 554 (1991), concerns the issue of when a sale or exchange has taken place that results in realization of gain or loss under § 1001. In Cottage Savings, a financial institution exchanged its interests in one group of residential mortgage loans for another lender's interests in a different group of residential mortgage loans. The two groups of mortgages were considered "substantially identical" by the agency that regulated the financial institution.

The Supreme Court in Cottage Savings, 499 U.S. at 560-61, concluded that § 1.1001-1 reasonably interprets § 1001(a) and stated that an exchange of property gives rise to a realization event under § 1001(a) if the properties exchanged are

"materially different." In defining what constitutes a "material difference" for purposes of § 1001(a), the Court stated that properties are "different" in the sense that is "material" to the Code so long as their respective possessors enjoy legal entitlements that are different in kind or extent. Cottage Savings, 499 U.S. at 564-65. The Court held that mortgage loans made to different obligors and secured by different homes did embody distinct legal entitlements, and that the taxpayer realized losses when it exchanged interests in the loans. Cottage Savings, 499 U.S. at 566.

Section 1223(2) provides that, in determining the period for which the taxpayer has held property however acquired there shall be included the period for which such property was held by any other person, if under chapter 1 of Subtitle A such property has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as it would have in the hands of such other person. See also § 1.1223-1(b).

It is consistent with the Supreme Court's opinion in Cottage Savings to find that the distributions to Taxpayer from Trust 1 to Trust 2 will not differ materially from her interest in Trust 1. The distributions to Trust 2 are made under the powers given to the trustees under the terms of Trust 1. Accordingly, based upon the facts provided and the representations made, we conclude that the Five-Year Distribution and the Remainder Appointment from Trust 1 to Trust 2 will not result in a material difference in kind or extent to the legal entitlements, and no gain or loss is realized by the beneficiaries or Trust 1 on the distribution for purposes of § 1001(a). We further conclude that the basis of the assets of Trust 2 as well as the holding period for those assets will remain the same after the proposed distributions.

Ruling #2

Section 2501(a)(1) imposes a tax for each calendar year on the transfer of property by gift during such calendar year by any individual, resident or nonresident.

Under § 2511(a), the tax imposed by § 2501 shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 25.2511-2(b) of the Gift Tax Regulations provides that a gift is complete to the extent the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit or for the benefit of another.

Section 25.2511-1(g)(1) provides, in part, that the gift tax is applicable only to a transfer of a beneficial interest in property. It is not applicable to a transfer of bare legal title to a trustee.

Section 2514(b) provides that the exercise or release of a general power of appointment created after October 21, 1942, shall be deemed a transfer of property by the individual possessing such power. Section 2514(c)(1) provides that for purposes of § 2514, the term “general power of appointment” means a power which is exercisable in favor of the individual possessing the power (possessor), his estate, his creditors, or the creditors of his estate.

Section 2514(c)(3)(A) provides that in the case of a power of appointment created after October 21, 1942, which is exercisable by the possessor only in conjunction with another person, such power is not deemed a general power of appointment.

Section 25.2514-1(c) provides that a power of appointment exercisable for the purpose of discharging a legal obligation of the possessor for his pecuniary benefit is considered a power of appointment exercisable in favor of the possessor or his creditors. A power of appointment is not a general power of appointment if by its terms it is either exercisable only in favor of one or more designated persons or classes other than the possessors or his creditors, or the possessor’s estate or the creditors of his estate.

In this case, Trust 1 is an irrevocable trust and the Settlers did not retain any powers to change its disposition. Accordingly, the Settlers made completed gifts of the assets transferred to Trust 1 in Year 22. Under the terms of Trust 1, the trustee of Trust 1 may direct distributions of assets pursuant to the trustee’s discretionary authority under the terms of Trust 1. Taxpayer is not a trustee of Trust 1 and has no authority or discretion to direct transfers of assets from Trust 1 to a new trust. Accordingly, no transfer of property will be deemed to occur for purposes of § 2511. Therefore, based upon the facts provided and the representations made, we conclude that no aspect of either the Five-Year Distribution or the Remainder Appointment will give rise to a gift for purposes of § 2501 as to Taxpayer.

In this case, Taxpayer has an inter vivos power of appointment to appoint Trust 2 property to her descendants. The power is not exercisable in favor of Taxpayer, her creditors, her estate or the creditors of her estate. Further, this power is exercisable only with the consent of the Independent Trustee. Accordingly, Taxpayer’s inter vivos power of appointment is not a general power of appointment for purposes of § 2514. In the event Taxpayer serves as a trustee of Trust 2, Taxpayer may not participate in any decision as a trustee to make a discretionary distribution in her own favor; may not discharge her legal obligations, and, as a descendant of Settlers, may not participate in any decision as a trustee relating to discretionary distributions. Therefore, based upon the facts presented and representations made, we conclude that future distributions from Trust 2 will not be subject to gift tax as to Taxpayer.

Ruling #3

Section 2601 imposes a tax on every generation-skipping transfer. Section 2611(a) defines the term "generation-skipping transfer" to include a taxable distribution, taxable termination, and a direct skip.

Section 2631(a) provides that for purposes of determining the inclusion ratio, every individual shall be allowed a GST exemption amount which may be allocated by such individual (or his executor) to any property with respect to which such individual is the transferor.

Section 2632(e) provides, in part, that any portion of an individual's GST exemption which has not been allocated within the time prescribed by § 2632(a) shall be deemed to be allocated as follows--(A) first, to property which is the subject of a direct skip occurring at such individual's death, and (B) second, to trusts with respect to which such individual is the transferor and from which a taxable distribution or a taxable termination might occur at or after such individual's death.

Section 26.2632-1(c)(1)(ii) of the Generation-Skipping Transfer Tax Regulations provides that an affirmative allocation of GST exemption cannot be revoked, but becomes effective as of (and no earlier than) the date of the close of the ETIP with respect to the trust. If an allocation has not been made prior to the close of the ETIP, an allocation of exemption is effective as of the close of the ETIP by reason of the death of the transferor as provided in paragraph (d) of this section.

Section 26.2632-1(c)(2) provides, in part, that an ETIP is the period during which, should death occur, the value of transferred property would be includible (other than by reason of § 2035) in the gross estate of the transferor.

Section 26.2632-1(d)(1) provides that an allocation of decedent's unused GST exemption by the executor of the decedent's estate is made on a Form 706-NA (nonresidents). Section 26.2632-1(d)(2) provides that a decedent's unused GST exemption is automatically allocated on the due date for filing Form 706-NA to the extent not otherwise allocated by the decedent's executor on or before that date.

Section 2652(a) provides that the term "transferor" means in the case of any property subject to the tax imposed by chapter 11, the decedent. An individual shall be treated as transferring any property with respect to which such individual is the transferor.

Section 26.2652-1(a)(1) provides that the individual with respect to whom property was most recently subject to federal estate or gift tax is the transferor of that property for purposes of chapter 13. Thus, an individual may be a transferor even though there is no transfer of property under local law at the time the federal estate or gift tax applies. Section 26.2652-1(a)(2) provides that a transfer is subject to federal

estate tax if the value of the property is includible in the decedent's gross estate as determined under § 2031 or § 2103.

Section 2663(2) provides that the Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this chapter, including regulations (consistent with the principles of chapters 11 and 12) providing for the application of this chapter in the case of transferors who are nonresidents not citizens of the United States.

Section 26.2663-2(a) provides rules for applying chapter 13 to transfers by a transferor who is a nonresident not a citizen of the United States (NRA transferor). Every NRA transferor is allowed a GST exemption of \$1,000,000.

Section 26.2663-2(c)(3) provides that for purposes of this section, the provisions of § 26.2632-1(c), providing rules applicable in the case of an estate tax inclusion period (ETIP), apply only if the property transferred by the NRA transferor is subsequently included in the transferor's gross estate. If the property is subsequently included in the gross estate, then the nontax portion and the applicable fraction are determined as of the date of death.

In Example 6 of § 26.2663-2(d), T transferred property to an inter vivos trust the terms of which provided T with an annuity payable for 10 years or until T's prior death. The trust also provided that, at the end of the trust term, the remainder will pass to GC or GC's estate. The property transferred to the trust consisted of property subject to chapter 13 that has a value of \$100,000 and property not subject to chapter 13 that has a value of \$400,000. T allocated \$100,000 of GST exemption to the trust. In year 6 of the trust term, T died. At T's death, the trust corpus had a value of \$800,000, and \$500,000 was includible in T's gross estate as provided in §§ 2103 and 2104(b). Thus, \$500,000 of the trust corpus is subject to chapter 13 and \$300,000 is not subject to chapter 13. In the example, T allocates \$100,000 GST exemption to the initial transfer and the applicable fraction is determined based upon that allocation. However, the example also indicates that the allocations of T's GST exemption at death by either an affirmative allocation by the executor or an automatic allocation under § 26.2632-1(d)(2) will affect the calculation of the applicable fraction.

When Trust 1 was established and funded in Year 22, a date after January 1, 1967, Father was a citizen of Country A and Mother was citizen of Country B and both were residents of Country B. It is represented that Father and Mother were nonresident aliens not citizens of the United States at that time. The assets transferred to Trust 1 included assets that did not have a situs in the United States and securities in a U.S. corporation. The initial transfer to Trust 1 was not subject to gift tax because the Settlers were nonresident aliens not citizens of the United States and the assets transferred did not have a situs in the United States or were securities in a U.S. corporation that were not subject to gift tax under § 2501(a)(2). See § 25.2501-1(a)(3).

When Father died on Date 2, a portion of his gross estate for federal estate tax purposes included securities in a U.S. corporation. Under § 2652, Father is the transferor for GST tax purposes with respect to the assets included in his gross estate. The portion of Trust 1 representing the securities in the United States corporation is not exempt from chapter 13. The beneficiaries of Trust 1 include nonskip persons. Accordingly, the close of the ETIP period did not result in a direct skip. However, Trust 1 has GST potential because some of the beneficiaries include the surviving children of Taxpayer and Sister, i.e., Settlor's grandchildren. Accordingly, a taxable distribution might occur.

Father's GST exemption was not allocated to the nonexempt portion of Trust 1 on the date of the initial transfer. The Trust was subject to the ETIP rules. The executor did not allocate Father's GST exemption to the nonexempt portion of Trust 1 upon Father's death. Accordingly, under § 26.2632-1(d)(2), Father's GST exemption was automatically allocated to the nonexempt portion of Trust 1. It is represented that Father had sufficient GST exemption to allocate to the nonexempt portion of Trust 1 to produce an inclusion ratio of zero. The remaining portion of Trust 1, consisting of property that was not subject to gift or estate tax, is exempt from chapter 13 under § 2663. Therefore, based on the facts submitted and representations made, we conclude that no aspect of either the Five-Year Distribution or the Remainder Appointment will cause the generation-skipping transfer tax under § 2601 to apply to an otherwise taxable termination or taxable distribution from Trust 2.

Ruling #4

Section 2031(a) provides that the value of the gross estate of the decedent shall be determined by including to the extent provided for in this part, the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated.

Section 2036(a) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

Section 2038(a)(1) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment

thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power) to alter, amend, revoke, or terminate, or where any such power is relinquished during the 3-year period ending on the date of the decedent's death.

Section 2041(a)(2) provides that the value of the gross estate shall include the value of all property to the extent of any property with respect to which the decedent has at the time of his death a general power of appointment created after October 21, 1942, or with respect to which the decedent has at any time exercised or released such a power of appointment by a disposition which is of such nature that if it were a transfer of property owned by the decedent, such property would be includible in the decedent's gross estate under §§ 2035 to 2038, inclusive.

Section 2041(b)(1) provides that the term "general power of appointment" means a power which is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate.

Section 20.2041-1(c)(1) of the Estate Tax Regulations provides, in part, that a power of appointment exercisable for the purpose of discharging a legal obligation of the decedent or for his pecuniary benefit is considered a power of appointment exercisable in favor of the decedent or his creditors. Section 20.2041-1(c)(1)(a) provides that a power of appointment is not a general power if by its terms it is exercisable only in favor of one or more designated persons or classes other than the decedent or his creditors, or the decedent's estate or the creditors of his estate.

In the present case, Taxpayer is a beneficiary of Trust 2. Taxpayer is not the transferor of the property transferred to Trust 2. Bank, the trustee of Trust 1, is exercising its discretionary authority under Trust 1 to transfer property from Trust 1 to Trust 2 to benefit Taxpayer. Therefore, Trust 2 is not includible in Taxpayer's gross estate under § 2036 or § 2038. Further, Taxpayer is not currently a trustee of Trust 2. If named as a trustee, Taxpayer may not participate in any decision as a trustee to make discretionary distributions in her favor or to discharge her legal obligations.

Taxpayer possesses a testamentary power of appointment to appoint Trust 2 to Settlers' descendants. However, Taxpayer may not appoint Trust 2 property to herself, her creditors, her estate, or the creditors of her estate. Accordingly, Taxpayer's power of appointment is not a general power of appointment. Therefore, Trust 2 is not includible in Taxpayer's gross estate under § 2041. Consequently, based upon the facts submitted and the representations made, we conclude that no aspect of either the Five-Year Distribution or the Remainder Appointment will cause the inclusion of any part of Trust 2 in the gross estate of Taxpayer.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Lorraine E. Gardner
Senior Counsel, Branch 4
(Passthroughs & Special Industries)

Enclosures (2)
Copy for § 6110 purposes

cc: